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SECRET SECTION 01 OF 03 BELGRADE 0336  
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DEPT PASS: P - UNDERSECRETARY EAGLEBURGER  
EUR - ASSISTANT SECRETARY BURT  
EB - ASSISTANT SECRETARY MCCORMACK  
PM - ADMIRAL HOWE

E.O. 12356: DECL: OADR  
TAGS: PEPR, EFIN, ETPD, EAGR, MASS, YO, US, NATO  
SUBJECT: YUGOSLAVIA AT THE CROSSROADS: A PROGRAM TO DEFEND  
U.S. INTERESTS

1. S - ENTIRE TEXT.

2. INTRODUCTION AND SUMMARY. OVER THE LAST 15 MONTHS, I HAVE WATCHED YUGOSLAVIA AND ITS LEADERSHIP DRIFT INTO A REAL ECONOMIC CRISIS. THIS DEVELOPMENT, COUPLED WITH DIFFICULTIES IN THE ETHNIC ALBANIAN AREA OF THE KOSOVO, HAS CAUSED STRAINS WITHIN THE FEDERAL AND REPUBLICAN LEADERSHIP GROUPS. SOME OF THESE STRAINS ARE POLITICAL IN NATURE, SOME ARE PART OF ANY NORMAL POLITICAL PROCESS, BUT MOST OF THEM ARE ROOTED IN YUGOSLAV ECONOMIC DIFFICULTIES. I HAVE REPORTED THESE DEVELOPMENTS OVER THE MONTHS, GIVING MY VIEWS ON THE NATURE OF THE PROBLEMS, AND PROPOSING ON OCCASION CERTAIN STEPS THE USG MIGHT TAKE TO ALLEVIATE THEM. THE FOLLOWING IS A MESSAGE WHICH TRIES TO PULL

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ALL OF THESE ASSESSMENTS AND PROPOSED STEPS TOGETHER INTO ONE PACKAGE. I AM NOT UNDERSTATING THE CASE WHEN I SAY THAT I THINK THAT YUGOSLAVIA AND ITS CURRENT PROBLEMS REQUIRE URGENT, HIGH-LEVEL ATTENTION IN WASHINGTON. THIS COUNTRY REMAINS AS IMPORTANT TO US STRATEGICALLY IN 1983 AS IT HAS OVER THE LAST 30-000 YEARS. END INTRODUCTION AND SUMMARY.

### 3. THE SITUATION

A. ECONOMIC/POLITICAL DIMENSIONS. TWO AND ONE-HALF YEARS AFTER THE DEATH OF TITO, YUGOSLAVIA IS AT A POLITICAL AND ECONOMIC CROSSROADS. HOW WE REACT NOW TO YUGOSLAVIA'S PRESSING ECONOMIC AND POLITICAL PROBLEMS WILL BE A CRITICAL FACTOR IN WHETHER U.S. INTERESTS IN THIS KEY STRATEGIC COUNTRY CAN BE SUSTAINED IN THE NEAR AND MEDIUM TERM.

A STAGGERING ECONOMY. THE YUGOSLAV ECONOMY IS IN A SEVERE LIQUIDITY CRISIS. IT MAY BE APPROACHING DEFAULT ON ITS INTERNATIONAL OBLIGATIONS. WHILE INAPPROPRIATE ECONOMIC CHOICES OVER THE YEARS HAVE CONTRIBUTED TO A BUILDUP OF PROBLEMS FAMILIAR TO DEVELOPING ECONOMIES--A HIGH LEVEL OF FOREIGN INDEBTEDNESS, INFLATION, AND SERIOUS UNEMPLOYMENT--A DECLINING WORLD ECONOMY HAS PUT THE POST-TITO YUGOSLAV LEADERSHIP IN A FISCAL STRAITJACKET. INDUSTRIAL OUTPUT IS SHARPLY FALLING, ENERGY CONSUMPTION IS BEING RATIONED AND A VIRTUAL CUTOFF OF SHORT-TERM AND MEDIUM-TERM LENDING BY MAJOR INTERNATIONAL BANKS HAS DRIED UP LIQUIDITY ESSENTIAL TO THE NORMAL FUNCTIONING OF THE ECONOMY. A MAJORITY OF THE CURRENT LEADERSHIP BELIEVES THAT RECOURSE TO A FORMAL RESCHEDULING WOULD COMPROMISE YUGOSLAVIA'S

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INDEPENDENCE AND REPRESENT A MAJOR POLITICAL DEFEAT FOR THE POST-TITO LEADERSHIP.

THE GOV HAS TAKEN A POLITICAL DECISION TO AVOID DEBT RESCHEDULING AT ALL COSTS. THE EXCRUCIATING CHOICES REMAINING POSE THE GREATEST CHALLENGE TO LEADERSHIP UNITY SINCE THE 1948 BREAK WITH STALIN. IN THE MEANTIME, UNPOPULAR FINANCIAL LIMITATIONS ON TRAVEL HAVE BEEN ADOPTED, THE CURRENCY HAS BEEN DEVALUED AND IMPORTS VITAL TO THE ECONOMY'S FUNCTIONING HAVE BEEN SEVERELY CUT BACK. THE END RESULT IS THAT YUGOSLAVIA'S ECONOMIC SITUATION --ALREADY BAD-- THREATENS TO BECOME MUCH WORSE UNLESS WE RESPOND QUICKLY. HOWEVER ILLOGICAL, THERE ARE SUSPICIONS AMONG THE LEADERSHIP ABOUT U.S. INTENTIONS TOWARD YUGOSLAVIA. IN PART THIS IS THE PRODUCT OF THE PROTRACTED LOAN EFFORT, IN PART OF A FIERCE COMMITMENT TO AN INDEPENDENCE OF BLOCS, IN PART A NATURAL TENDENCY TO BLAME OTHERS FOR ONE'S OWN FLAWS. THE YUGOSLAVS RECOGNIZE THEIR INDEPENDENCE HINGES ON INTERNAL STABILITY AND THE COUNTRY'S ECONOMIC VIABILITY. IN THIS, YUGOSLAV AND AMERICAN PERCEPTIONS--AND INTERESTS-- COINCIDE EXACTLY. THIS IS WHY THE LEADERSHIP, DESPITE ITS SUSPICIONS AND ITS DESIRE TO AVOID DEPENDENCE ON EITHER SUPER POWER, HAS TURNED FIRST TO US: WITNESS, THEN-PRESIDENT KRAIGHER'S MEETING WITH THE PRESIDENT AT CANCUN, MOSCOW'S WESTWARD-LOOKING INAUGURAL FOREIGN POLICY ADDRESS THIS SUMMER, AND PRESIDENT STAMBOLIC'S JULY LETTER TO THE PRESIDENT (STATE 191710) ASKING THAT HE SUPPORT YUGOSLAVIA'S LOAN EFFORT.

#### 4. U.S. INTERESTS

YUGOSLAVIA'S UNITY AND STURBORN INDEPENDENCE OF BLOCS SERVES OUR STRATEGIC INTEREST IN THE BALKANS AND MEDITERRANEAN AS WELL AS OUR POLITICAL INTEREST IN ENCOURAGING THE ATTENUATION AND EVENTUAL DISSOLUTION

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OF THE SOVIET EMPIRE. YUGOSLAVIA'S INDEPENDENCE SERVES  
U.S. INTERESTS IN SEVERAL AREAS:

**A. GEOPOLITICAL.**

NAVAL. THE ADRIATIC IS AN OPEN SEA, THE WARSAW  
PACT IS DENIED BASES THERE, AND THE SOVIET THREAT TO  
NATO ALLIES GREECE AND ITALY AND TO THE MIDDLE EAST IS  
AS A CONSEQUENCE SUBSTANTIALLY LESS.

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AIR. YUGOSLAVIA CONTROLS THE ONLY AIR CORRIDOR FROM THE WARSAW PACT TO THE MEDITERRANEAN AND THE MIDDLE EAST THROUGH NON-NATO AIRSPACE. THE SOVIETS ARE DENIED ADRIATIC AIRFIELDS. THUS THEY HAVE NO TACTICAL AIR SUPPORT FOR THE SOVIET MEDITERRANEAN FLEET. GROUND. YUGOSLAV GROUND DEFENSE IS PRIMARILY GEARED TO REPELLING AN ATTACK FROM THE WARSAW PACT. IT IS ALSO PRESUMABLY DETERMINED TO BLOCK ANY MOVE THROUGH NORTHERN YUGOSLAVIA BY PACT FORCES SEEKING TO ENTER NORTHERN ITALY VIA THE GORIZIA GAP. B. ECONOMIC. U.S. ECONOMIC INTERESTS IN YUGOSLAVIA ARE SUBSTANTIAL. THE YUGOSLAVS HAVE PURCHASED BILLIONS OF DOLLARS WORTH OF U.S. MADE INDUSTRIAL EQUIPMENT, AGRICULTURAL PRODUCTS, AND MANUFACTURED GOODS (\$6.3 BILLION SINCE 1965). THE PRESENCE OF WELL-KNOWN U.S. AND OTHER WESTERN PRODUCTS THROUGHOUT THE COUNTRY CONSTANTLY UNDERSCORES THE EFFICACY OF THE INDUSTRIAL DEMOCRACIES IN PRODUCING A RISING STANDARD OF LIVING AND THE MATERIAL WELL BEING ASSOCIATED WITH WESTERN

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LIFE. SEFING THIS, THE YUGOSLAWS CONTINUED TO WORK TOWARD A MARKET-ORIENTED ECONOMY, SEEKING TO STIMULATE THEIR FIRMS TO GREATER EFFICIENCY THROUGH COMPETITION WITH FOREIGN FIRMS BOTH IN EXPORT AND DOMESTIC MARKETS. FOREIGN PRIVATE INVESTORS ARE WELCOMED, AND THE U.S. IS THE LARGEST FOREIGN EQUITY INVESTOR IN YUGOSLAVIA. YUGOSLAVIA IS A FULL MEMBER OF THE GATT, THE IMF, AND THE WORLD BANK. ALL THIS TAKES PLACE UNDER A SYSTEM THAT IS NOMINALLY SOCIALIST, GREATLY MAGNIFYING THE YUGOSLAV EXAMPLE'S IMPACT ON ITS NEIGHBORS TO THE EAST. C. POLITICAL.

YUGOSLAVIA, THE PRIZE THAT ELUDED STALIN IN 1948, STILL CAUSES GNASHING OF TEETH IN THE KREMLIN. WE GAVE TITO THE HELP THAT WAS ESSENTIAL TO KEEP YUGOSLAVIA INDEPENDENT WHILE HE THEN BEGAN, OUT OF NECESSITY, TO BE SURE, THE SOMETIMES FITFUL PROCESS THAT HAS OPENED YUGOSLAVIA TO THE WEST, PERMITTED EVOLUTION IN THE DIRECTION OF PLURALISM, ACHIEVED SUBSTANTIAL ECONOMIC GROWTH, AND FOSTERED RECEPTIVITY TO WESTERN ATTITUDES AND CULTURE. AS A RESULT YUGOSLAVIA IS WELL ALONG A COURSE THAT IS THE ENVY OF THE SATELLITE COUNTRIES OF THE WARSAW PACT (WITH THE PARTIAL EXCEPTION OF HUNGARY), AND IS GRADUALLY EVOLVING IN THE DIRECTION OF PEACEFUL DEMOCRATIC CHANGE.

**5. MEASURES.**

STEPS, YUGOSLAVIA IS AT THE CROSSROADS. A PROTRACTED ECONOMIC CRISIS COULD THREATEN YUGOSLAVIA'S INDEPENDENT COURSE. IT COULD SERIOUSLY WEAKEN YUGOSLAVIA'S ABILITY TO WITHSTAND SOVIET PRESSURES FOR POLITICAL AND MILITARY CONCESSIONS AND ATTENUATE THE EVOLUTION TOWARD PLURALISM IN THE COMMUNIST WORLD. WE BELIEVE THAT THE FOLLOWING SET OF MEASURES IS NEEDED NOW TO UNDERPIN OUR CONTINUING INTEREST IN AN

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INDEPENDENT YUGOSLAVIA. THESE MEASURES ARE:

A. ECONOMIC/FINANCIAL.

-- \$200 MILLION SYNDICATION. WE ASSUME THE CITICORP-LED \$200 MILLION LOAN WILL SHORTLY BE SIGNED AND DISBURSED. MOST YUGOSLAV LEADERS HAVE NOT UNDERSTOOD THE USG'S INABILITY TO PERSUADE THE BANKS TO LEND. AS I HAVE BEEN TOLD MANY TIMES BY MY YUGOSLAV INTERLOCUTORS, THE GOY VIEWS THE LOAN AS AN EARNEST INDICATION OF U.S. INTENTIONS; ITS COLLAPSE WOULD HAVE AN EXTREMELY NEGATIVE IMPACT ON U.S. YUGOSLAV RELATIONS.

-- U.S. SUPPORT FOR A BIS FACILITY. THE YUGOSLAVS HAVE INFORMALLY RAISED THE QUESTION OF A \$500 MILLION BIS FACILITY WITH THE GERMANS, FRENCH, SWISS, ITALIANS, AND BRITISH, AND THE FED. A POSITIVE U.S. RESPONSE WILL BE ESSENTIAL IF A STANDBY CREDIT LINE IS TO BE ARRANGED. IN THE ABSENCE OF A BIS CREDIT FACILITY, YUGOSLAVIA'S FINANCIAL RESERVES--ALREADY AT DANGEROUSLY LOW LEVELS--WILL BE EXHAUSTED BY YEAR'S END.

-- CCC (COMMODITY CREDIT CORPORATION) CREDITS COULD EASE THE HARD CURRENCY BURDEN FOR NEEDED IMPORTS THIS YEAR OF WHEAT, COTTON, SOY BEANS, VEGETABLE OILS, AND SOYBEAN MEAL. (SEE BELGRADE 8291 AND PREVIOUS) DESPITE EFFORTS TO CONSERVE AND STRETCH CURRENT STOCKS, TOTAL NEEDS COULD TOP \$400 MILLION. I AM TOLD THAT THE NEED FOR COTTON IS ESPECIALLY PRESSING.

-- EXIMBANK FACILITIES. IT IS CRUCIAL THAT THE EXIMBANK KEEP ALL OF ITS PROGRAMS AVAILABLE FOR YUGOSLAVIA AT THIS DELICATE JUNCTION; CURTAILMENT OF ANY OF THEM WOULD SURELY BE READ HERE AS A HOSTILE SIGNAL.

-- EXIMBANK'S 90 MILLION CREDIT LINE TO MONTENEGRO. DESPITE EXIMBANK'S WILLINGNESS TO BE FLEXIBLE IN THE APPLICATION OF PROJECT CRITERIA, NO DRAWINGS ON THIS FAVORABLE CREDIT FACILITY HAVE BEEN MADE BY THE MONTENEGRINS. WE WILL EXPLORE ON AN

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URGENT BASIS STEPS TO EASE ADMINISTRATIVE BARRIERS  
TO THE PRODUCTIVE USE OF THIS CREDIT.

-- REPROGRAMMING OF EXIMBANK LOANS. DISTASTEFUL  
AS IT IS, WE MUST FACE UP TO THE FACT THAT THREE OF  
YUGOSLAVIA'S MOST FINANCIALLY TROUBLED PROJECTS (THE  
KRSKO NUCLEAR PLANT, THE DOM-INA PETROCHEMICAL COMPLE,  
AND THE FENI NICKEL COMPLEX) WERE CONSTRUCTED WITH  
EXIMBANK LOANS AND THE MOST MODERN U.S. TECHNOLOGY.  
DEBT SERVICE FOR THESE PROJECTS REPRESENTS THE BULK OF  
THE APPROXIMATELY \$460 MILLION DUE EXIMBANK IN INTEREST

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AND PAYMENTS IN 1982-84. WE SHOULD BE PREPARED TO  
RESPOND SYMPATHETICALLY TO REQUESTS FOR A PAYMENTS  
STRETCH-OUT AND PRESS THE GERMANS, FRENCH, BRITISH, AND  
JAPANESE TO DO THE SAME ON THEIR OFFICIAL DEBTS. THIS  
ACTION, COUPLED WITH A MAJOR BIS LOAN, WOULD ENCOURAGE  
OUR BANKS TO OPEN THEIR PURSE STRINGS.

**B. MILITARY COOPERATION.**

A SIGNIFICANT GROUP WITHIN THE GOY LEADERSHIP IS  
CONCERNED BY THE DEGREE TO WHICH YUGOSLAVIA IS DEPENDENT  
UPON THE SOVIET UNION FOR MILITARY HARDWARE. U.S.  
POLICY HAS SOUGHT TO ASSIST THE YUGOSLAVS IN THE PROCUREMENT  
OF SPECIALIZED WEAPONS SYSTEMS BASED ON THE  
PREMISE THAT A DIVERSIFICATION OF SUPPLY WOULD STRENGTHEN  
YUGOSLAVIA'S INDEPENDENCE FROM MOSCOW. YUGOSLAVIA'S  
SEVERE FINANCIAL CONSTRAINTS HAVE COMPROMISED OUR  
EFFORTS TO DEVELOP A MEANINGFUL MILITARY SALES PROGRAM.  
THERE ARE, HOWEVER, A NUMBER OF AREAS WHERE WE SEE  
SCOPE FOR CLOSER MILITARY COOPERATION WITH THE YUGOSLAVS

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(SOME OF WHICH WOULD APPEAR TO REQUIRE LEGISLATIVE ACTION).

--F5G AND RELEASE OF THE PW1120 AIRCRAFT ENGINE. DISCUSSIONS FOR THE PURCHASE OF THE F5G ARE AT A RELATIVELY ADVANCED POINT. ASSUMING THAT WASHINGTON APPROVAL FOR THE SALE WILL BE FORTHCOMING, THE STICKING POINT WILL BE FINANCING FOR THE AIRCRAFT AND THE DEGREE OF OFFSET PURCHASES THAT NORTHROP MAY BE WILLING TO ACCEPT. WE SHOULD DISCREETLY USE OUR INFLUENCE TO ENCOURAGE NORTHROP TO BE FLEXIBLE IN THIS AREA AND SHOULD AGAIN EXPLORE THE POSSIBILITY OF FMS CREDITS (HERETOFORE THE YUGOSLAVS HAVE SEEN FMS CREDITS AS INCONSISTENT WITH THEIR NON-ALIGNED STATUS.) TO FINANCE PART OF THE PURCHASE. THE PLANNED VISIT OF SECRETARY WEINBERGER WILL PROVIDE AN EXCELLENT OCCASION FOR CONCRETE DISCUSSIONS ON THIS TOPIC.

-- SALES OF MILITARY EQUIPMENT FOR LOCAL CURRENCY. IT IS MY UNDERSTANDING THAT LEGISLATIVE PROVISIONS CURRENTLY RESTRICT THE SALE OF MILITARY HARDWARE FOR LOCAL CURRENCIES. THE HARD CURRENCY DEBT REQUIREMENTS OF YUGOSLAVIA BULK SO LARGE IN 1982-85 THAT AN EXPANSION OF MILITARY COOPERATION IS UNLIKELY UNLESS WE CAN FIND A WAY TO ACCEPT PARTIAL PAYMENT IN DINARS. THERE IS PRECEDENT FOR SUCH AN ARRANGEMENT AS WE ACCEPTED A "PESETA OFFSET" IN A MAJOR ARMS DEAL WITH SPAIN. WHILE I DO NOT UNDERESTIMATE THE LEGISLATIVE HURDLES, SPECIAL RIDER LEGISLATION WAS DEVELOPED TO ASSIST POLAND (SEE SECTION 709(A) AND (R) OF THE LAW FOR THE RESTORATION OF CERTAIN AUTHORITIES FORMERLY CONTAINED IN THE FOREIGN SERVICE ACT) AND WE MIGHT CONSIDER EXPLORING A SIMILAR APPROACH TO ASSIST THE GOY IN THE PROCUREMENT OF DEFENSIVE WEAPONRY.

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-- IMET TRAINING. WHILE NOT A SUBSTITUTE FOR EXPANDED COOPERATION IN ARMS PROCUREMENT, AN EXPANDED IMET PROGRAM WOULD PROVIDE AN IMPORTANT SIGNAL TO THE YUGOSLAVS AND ENABLE US TO MONITOR MORE EFFECTIVELY ATTITUDES IN THE YUGOSLAV ARMED FORCES. (WE RELIEVE YUGOSLAVS' DECISION NOT TO AVAIL THEMSELVES OF ALL THE EXPANDED IMET PROGRAM POSSIBILITIES THIS YEAR WAS A ONE-TIME EXCEPTION.) OUR ACCESS TO THE UPPER ECHELONS OF THE YUGOSLAV MILITARY SHOULD BE ENHANCED AS OFFICERS WITH EXPOSURE TO THE U.S. MILITARY MOVE UP THE COMMAND CHAIN.

**C. MAINTAINING THE BILATERAL DIALOGUE AT A HIGH LEVEL.**

VISITS BY SENIOR U.S. OFFICIALS CAN COMPLEMENT, BUT NOT SERVE AS A SUBSTITUTE FOR THE MEASURES LISTED ABOVE. IF WE ADOPT THESE MEASURES WE WILL BE IN A POSITION TO GIVE SUBSTANCE TO FORTHCOMING BILATERAL EXCHANGES SUCH AS THE PROSPECTIVE VISIT OF SECRETARY WEINBERGER. TO BE SURE, THESE VISITS HAVE AN INTRINSIC VALUE OF THEIR OWN BECAUSE THEY VISIBLY GIVE VALUE TO AND VITALIZE THE BILATERAL RELATIONSHIP. THE RECENT CONVERSATION BETWEEN SECRETARY SCHULTZ AND SECRETARY MOJSOV IS AN EXCELLENT EXAMPLE OF THE WORTH OF HIGH-LEVEL TALKS. BUT WE SHOULD NOT DELUDE OURSELVES: THE COY EXPECTS THAT MATERIAL SUPPORT WILL BE LINKED WITH THESE EXCHANGES.

**D. TAKING THE LEAD WITH NATO ALLIES.**

AS WE MOVE TO PUT THE BILATERAL MEASURES MENTIONED ABOVE IN PLACE, WE RECOMMEND ENCOURAGING OUR ALLIES, FIRST USING THE QUAD FRAMEWORK, TO INITIATE BILATERAL ACTIONS OF THEIR OWN, NAMELY DEBT RELIEF, BILATERAL TRADE, AND JOINT FRANCO/ANGO/GERMAN INITIATIVES TO ALLEVIATE EC TRADE RESTRICTIONS WHICH HAVE HAMPERED

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YUGOSLAV TRADE WITH WESTERN EUROPE.

**6. CONCLUSION.**

U.S. POLICY TOWARD YUGOSLAVIA HAS BEEN A SUCCESS FOR 30 YEARS. OUR POLICY HAS BEEN A MAJOR FACTOR IN MAINTAINING PEACE IN EUROPE. A SOVIET THRUST THROUGH THE BALKANS TOWARD THE MEDITERRANEAN AND THE MIDDLE EAST HAS BEEN COUNTERED. WE HAVE PROMOTED A GRADUALLY INCREASING WESTWARD ORIENTATION OF YUGOSLAVIA'S ECONOMIC, SOCIAL, AND EVEN POLITICAL LIFE. SINCE THE EARLY 70'S OUR COSTS IN ADVANCING THESE IMPORTANT INTERESTS HAVE BEEN MINIMAL. AT THIS CRUCIAL TIME IN YUGOSLAVIA'S EVOLUTION, IT STRIKES ME AS NOT ONLY PRUDENT BUT EVEN URGENT TO AUGMENT OUR LONG-TERM INVESTMENT IN ORDER TO PRESERVE THE ADVANTAGES WE GAIN FROM YUGOSLAVIA'S POLICY OF FIERCE INDEPENDENCE OF BLOCS. ACCORDINGLY, I URGE PROMPT AND FAVORABLE CONSIDERATION OF THE PACKAGE SET FORTH IN SECTION III.

7. REQUEST DEPARTMENT PASS THIS MESSAGE TO ALL INTERESTED AGENCIES INCLUDING EXIMBANK.  
ANDERSON

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